

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER 96-0036

Sales & Use Tax

For The Tax Years: 12/31/92 Through 12/31/94

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ISSUES

I. Sales & Use Tax - Various Adjustments

Authority: IC 6-2.5-2-1; IC 6-2.5-3-1; IC 6-2.5-3-2; IC 6-2.5-4-1; IC 6-2.5-5-3; IC 6-2.5-5-6; IC 6-2.5-5-8; IC 6-2.5-5-9; IC 6-2.5-5-20; *Miles, Inc. v. Indiana Department of State Revenue*, 659 N.E.2d 1158 (Ind.Tax 1995)

The taxpayer protests the Department's use tax adjustments.

II. Tax Administration - Negligence Penalty

Authority: IC 6-8.1-10-2.1; 45 UAC 15-11-1 & 2

The taxpayer protests the ten percent (10%) penalty for negligence.

STATEMENT OF FACTS

The taxpayer is a California corporation with its commercial domicile in Indianapolis, Indiana. It produces calendars and posters for sale and distribution throughout the United States. Taxpayer's staff works in conjunction with artists and other creative consultants in the design of these products. The taxpayer purchases artwork and photos from outside artists and photographers but makes various alterations to these images which include adding titles, borders, and colors. The modified images are forwarded to printers for scanning and creating electronic files (known as OPI's). OPI's are returned to the taxpayer where specialized computer hardware and software merge the items with a grid. Next, the OPI's are forwarded to a printer to create proofs, which are typically exchanged between the printer and taxpayer until final approval is granted. These proofs are used to make plates for printing the calendars and posters. After the calendars and posters are printed, they are returned to the taxpayer for rolling, plastic wrapping, labeling, and packaging. Each group of orders

is placed on pallets and stretch wrapped for shipment.

At the taxpayer's Indianapolis location, the taxpayer receives pieces of flat cardboard or other unassembled displays. These displays are then fabricated at the Indianapolis location. The fabrication process varies depending on the type of display being assembled. Flat pieces of cardboard are physically assembled and constructed, per instructions, to form storage displays for calendars. Other displays are constructed from different parts delivered to the Indianapolis location and connected together to fabricate a display. Fabricated displays are sent to Indianapolis customers and to customers outside Indiana. Sometimes displays are sent unassembled to a customer's location.

In reviewing taxpayer's purchase invoices, the Department has proposed a number of use tax adjustments. Below are the proposed adjustments the taxpayer protests. This Letter of Findings only addresses those items assessed in the audit.

I. Use Tax - Various Adjustments

DISCUSSION

a. The Use Tax Exceptions

The taxpayer protests the proposed assessment of use tax imposed on purchases of various displays and display pieces to the extent these items were delivered into Indiana, temporarily stored at its Indianapolis warehouse, and subsequently shipped to customers outside Indiana. In addition, the taxpayer protests the proposed assessment of use tax on the purchase of unassembled display pieces delivered into Indiana, assembled at taxpayer's Indianapolis location, and shipped to customers outside Indiana (Taxpayer does not protest tax on approximately 3% of such purchases because they were shipped to Indiana customers).

With regard to the displays and display pieces temporarily stored in Indiana, taxpayer argues these purchases are excepted from Indiana's use tax. IC 6-2.5-3-2 provides in part:

(a) An excise tax known as the use tax, is imposed on the *storage, use*, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction. (Emphasis added).

The term *use* is defined as "the exercise of any right or power of ownership over tangible personal property. IC 6-2.5-3-1(a). While *storage* means "the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana." IC 6-2.5-3-1(b). The issue is whether the taxpayer's activities trigger the use tax.

In *Miles, Inc. v. Indiana Department of State Revenue*, 659 N.E.2d 1158 (Ind.Tax 1995) the Indiana

Tax Court reaffirmed that the storage exception limits, and qualifies the meaning of the word “*use*”. *Id.* at 1164. “If property is stored in Indiana for subsequent use outside Indiana, then the activities of storing, handling, and transporting the property cannot be taxed as ‘uses.’ To hold otherwise would subsume ‘storage’ within ‘use,’ and nullify the exception for subsequent use outside Indiana.” *Id.* Likewise, a tax on these purchases would nullify the storage exception. The Department finds that these items are excepted from the use tax.

In the case of display pieces assembled in Indiana, taxpayer raises IC 6-2.5-3-2(d):

Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining or exercising of any right or power over tangible personal property, if:

- (1) the property is delivered into Indiana by or for the purchaser of the property;
- (2) the property is delivered in Indiana for the sole purpose of being processed, printed, *fabricated*, or manufactured into, attached to, or incorporated into other tangible personal property; and
- (3) the property is subsequently transported out of state for use solely outside Indiana.

(Emphasis added).

Taxpayer contends its activities constitute fabrication within the meaning of the statute. Taxpayer states its staff assemble the pieces into display units for shipment and use outside Indiana. The Department finds that such activities fall within the statute.

FINDING

Taxpayer’s protest is sustained subject to audit verification that the displays and display pieces are indeed shipped into Indiana and that the 97% of them are again shipped outside of Indiana.

b. Exempt Transactions

The taxpayer protests the proposed assessment of use tax on the following transactions:

- (A) Purchases from an Indiana location that are delivered outside Indiana for use outside Indiana;
- (B) Purchases from non-Indiana vendors picked-up by taxpayer’s customers for use by the taxpayer outside Indiana; and
- (C) Purchases from non-Indiana vendors that are picked-up by a common carrier, delivered

outside Indiana, for the taxpayer's use outside Indiana. Taxpayer contends that these sales are (1) not Indiana retail transactions; (2) not subject to Indiana use tax; and (3) sales in interstate commerce.

FINDING

Taxpayer's protest is sustained.

c. Service Transactions

Taxpayer protests the proposed assessment of tax on various service transactions. Per IC 6-2.5-2-1(a) sales tax is imposed on Indiana retail transactions, which is defined under IC 6-2.5-4-1 to include certain transfers of tangible personal property by retail merchants. The tax applies to service activities as specified under the statute. Taxpayer protests use tax on purchases of film, negatives, and proofs, customized artwork, separately stated maintenance and installation charges, photo fees for reproduction rights, service agreements and other miscellaneous services. The Department agrees that a portion of these are nontaxable services, and that some can be characterized as purchases of tangible personal property. In addition, separately stated installation charges will be taxable prior to transfer.

FINDING

Taxpayer's protest is sustained subject to audit verification.

d. Non-returnable Packaging

Taxpayer protests the proposed assessment of use tax on purchases of non-returnable packaging. The taxpayer purchases pallets, strapping materials, cartons, and other packaging materials as non-returnable packaging for enclosures of its products. IC 6-2.5-5-9 (d) provides:

Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds.

According to Information Bulletin #44, as a general rule Indiana sales tax does not apply to sales of non-returnable containers to be used by the purchaser as enclosures or containers for selling contents to be added. To qualify for this exemption, non-returnable wrapping materials and empty containers must be used by the purchaser in the following way:

1. The purchaser must add contents to the containers purchased, and
2. The purchaser must sell the contents added.

Also, non-returnable containers include steel strap and shipping pallets to be used by the purchaser

as enclosures for selling tangible personal property.

FINDING

Taxpayer's protest is sustained.

e. Purchases from Advertising Agencies

Taxpayer protests the proposed assessment of use tax on purchases from advertising agencies in which the advertising agencies were not required to collect sales tax. Sales Tax Information Bulletin #14 provides that the advertising agency may pay the sales tax for his principal. According to the taxpayer the advertising agency paid the sales tax and passed it on to the taxpayer.

FINDING

Taxpayer's protest is sustained subject to audit verification that sales tax was actually paid by the advertising agencies.

f. Sale for Resale

Taxpayer protests the proposed assessment of use tax on purchases of items to be resold. Taxpayer purchases pocket calendars and pocket inserts for resale. IC 6-2.5-5-8 provides an exemption for such purchases. Indiana Code section 6-2.5-5-8 provides in pertinent part: Transactions involving tangible personal property are exempt from...gross retail tax...if the person acquiring the property acquires it for resale....

FINDING

Taxpayer's protest is sustained.

g. Production Equipment

Taxpayer protests the proposed assessment of use tax on purchases of production equipment. Taxpayer uses label makers, ribbons, and other related items for the production of product labels. IC 6-2.5-5-3 provides an exemption for such purchases.

FINDING

Taxpayer's protest is sustained subject to audit verification that the items exempted are only those used in the production of product labels so long as the labels are not used for packaging or shipping purposes.

h. Food

Taxpayer protests the proposed assessment of use tax on purchases of food items. Taxpayer purchased turkeys and hams as holiday gifts for its employees. These food items are exempt pursuant to IC 6-2.5-5-20 as food for human consumption.

FINDING

Taxpayer's protest is sustained.

i. Materials Incorporated into the Final Product

Taxpayer protests the proposed assessment of use tax on purchases of product identification labels incorporated into the final product. IC 6-2.5-5-6 provides an exemption for raw materials incorporated into a final product. However, several items listed by the taxpayer as non-taxable were coded by the taxpayer as shipping supplies. A determination must be made whether or not these items are incorporated into the final product.

FINDING

Taxpayer's protest is sustained subject to audit verification.

II. Tax Administration - Negligence Penalty

DISCUSSION

The taxpayer protests the Department's imposition of the ten percent (10%) penalty assessment. Indiana Code section 6-8.1-10-2.1 requires a ten percent (10%) penalty to be imposed if the tax deficiency is due to the negligence of the taxpayer. Department regulation 45 IAC 15-11-2 provides guidance in determining if the taxpayer was negligent in nature.

Departmental regulation 45 IAC 15-11-1(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is also to be determined on a case-by-case basis according to the facts and circumstances of each taxpayer.

Subsection (d) of IC 6-8.1-10-2.1 allows the penalty to be waived upon a showing that the failure to pay the deficiency was due to reasonable cause. Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish reasonable cause, the taxpayer must show that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. . . ."

In this instance, the taxpayer has shown reasonable cause. The taxpayer has provided to the Department's satisfaction, sufficient justification for interpreting the code as it did.

FINDING

The taxpayer's protest is sustained. The taxpayer has provided to the Department's satisfaction, sufficient justification for interpreting the code as it did.